"Relational therapy" for retail franchisers and franchisees

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"Relational Therapy" for Retail Franchisers and Franchisees: Staging into the Experience Economy

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Abstract
Retail franchisers struggle to differentiate their businesses in an increasingly commoditizing environment. In order to differentiate, these retailers have to adjust their processes and offerings, but this may harm the franchiser's unified concept and lead to more opportunistic behavior of the franchisees. We believe that staging experiences may solve these problems for certain retail franchisers. This paper has two main objectives. The first objective is to provide some "relational therapy" for franchisers and franchisees that are struggling with the paradox of differentiating their businesses in a highly commoditized environment in spite of the standardized franchise settings. The second aim is to solve the paradox of keeping the commitment of the franchisees high and controlling the risk of opportunistic behavior by punishing defective franchisees. As a result, franchisers and franchisees must find a balance between dealing with internal conflicts and creating customer value. By using a comprehensive research model that takes into account the "ménage à trois" between franchiser, franchisee and customer, instead of dual relationships, the second paradox is untangled. Finally, we address the limitations of the concept and future directions are outlined.

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1. Introduction

In franchising relationships one firm (the franchiser) allows another firm (the franchisee) to use its trade name or business format in operating a business in return for fees. Other services like store design, training or the supply of products may also be provided by the franchiser (Dnes, 1992). In the past decades, a significant amount of research has been conducted in the field of franchising in various disciplines, like law, economics, marketing and management science (Elango and Fried, 1997). However, in the franchising literature these relationships are often viewed from narrowly defined perspectives and are often approached as static relationships (Elango and Fried, 1997). From the bulk of the franchising literature, it seems that the franchiser's primary goal is to coordinate and control franchisees by means of monitoring. In this literature, the agency theory is often used to emphasize the coordination difficulties and the possible opportunistic behavior of franchisees (Elango and Fried, 1997). Although authors have increasingly focused on the franchising relationship from the viewpoint of the franchisee (cf. Morrison, 2001), it is striking that few of these authors stress the importance of creating and delivering value to customers. So, instead of focusing on perhaps the most important party involved in the value system -the customer-, the franchising literature mainly focuses on conflicts within the franchising relationship (e.g. Tuunanen and Hyrsky, 2001; Morrison, 2001).

This lack of attention for customers is surprising because today's customers have become more demanding. According to Blackwell (1997), today's customers are less and less satisfied with shopping and, besides, they think all retailers look alike. Moreover, from an investigation performed by Deloitte and Touche (1996) it turned out that 47% of the respondents felt that shopping in the retail stores is an unpleasant chore. According to Britt Beemer, chairman and founder of America's Research Group, this percentage even is an understatement: "Seventy-four percent of customers tell us that all stores within the same category look alike and that the merchandising is boring. There are just a few bold merchandisers out there willing to take a stand and make a statement." In the increasing commoditizing retail industry, it is imperative to differentiate in order to survive, but how should this be implemented with the highly standardized strategy of franchisers and franchisees?

So, modern customers demand a more enjoyable shopping experience, but, paradoxically, retailers more and more engage in relationships with franchisers that offer an established and highly standardized business format (Fulop & Forward, 1997). This yields a problem for franchisers, namely finding a balance between standardizing the business format and allowing for deviations from the business format by franchisees to individual consumers.

To initiate a turnaround, we emphasize the importance of delivering value to customers by implementing a more open communication structure within the franchising system and by delivering memorable experiences to customers. In our belief, some –but not all- retail franchisers can adopt the strategy of staging experiences to overcome the relative lack of customer orientation and differential power that is likely to be apparent. To indicate which franchise formulas can adopt this strategy; we also provide some requisites in order to increase the changes of success.

This paper has two main objectives. The first objective is to provide some "relational therapy" for franchisers and franchisees that are struggling with the paradox of differentiating their businesses in a highly commoditized environment in spite of the standardized franchise settings. The second aim is to solve the paradox of keeping the commitment of the franchisees high and controlling the risk of opportunistic behavior by punishing defective franchisees. As a result of this paradox, franchisers and franchisees must find a balance between dealing with internal conflicts and creating customer value. The provision of value to customers is nowadays a "one-man show", because the franchiser preserves the exclusive right to determine the overall strategy. By using a more comprehensive research model that takes into account the "ménage à trois" between franchiser, franchisee and customer, instead of dual relationships, the second paradox is untangled (see Figure 1).

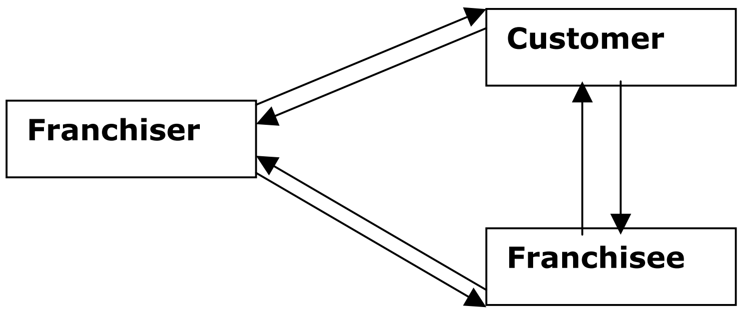

Figure 1: The “ménage à trois” between franchiser, franchisee and customer

The paper consists of five sections. In the following section, two important paradoxes are appointed that are apparent to retail franchisers. In section 3, we untangle these paradoxes by introducing a new monitoring structure and a new concept: The Experience Economy. In the fourth section, the applicability and the requirements of this innovative concept are addressed. In section 5, the managerial implications are summarized for an effective implication of the Experience Economy for retail franchisers. In the sixth section, some organizational transformations are proposed to guide the behaviors of franchisees.

2. Identifying the paradoxes

Franchising can be divided in ‘trade name franchising’ –i.e., merely using the trade name in return for fees and/or royalties (cf. Caves and Murphy, 1976)- or the more rigorous form of ‘business format franchising’ that institutes a method of operating and accompanying support for the franchisee (Bezemer, 1990). In such a relationship the franchisee is allowed to use a proven method of operating (i.e. the business format) next to the trade name. These business format franchising relationships are more likely to have problems in differentiating their business while minimizing internal conflicts. In this paper we focus on this latter form, because it entails the most intense form of franchising relationships in which the paradoxes are most apparent.

The first paradox is a result of "the paradox of governance" that is apparent in all forms of alliances (Nooteboom, 1999). This "paradox of governance" can be explained as follows: the partners want to create mutual advantage through cooperation, but they have to manage risks of dependence in the relationship given their goals and outside conditions. The franchiser faces a well-known management problem that refers to the opportunistic behavior of 'free riding' (e.g. Stanworth and Curran, 1999). This type of opportunistic behavior may harm the other franchisees involved. For instance, a lousy service provided by one franchisee is borne by the other members. To avoid damage to the system's reputation, monitoring and punishing defective behavior of franchisees seems inevitable. Unfortunately, these monitoring and punishing tasks, forcing franchisees to stick to the rules, can have a hidden consequence (Strutton et al., 1995). Through strictly monitoring and punishing franchisees that diverge from the commissioned behavior, the level of commitment of franchisees can be easily undermined. As a result, the joint effort to deliver superior customer value will be less fruitful. Here, the first paradox is identified; franchisers should minimize the opportunistic behavior by controlling its franchisees, but at the same time the level of commitment should be kept high in order to form a cohesive group.

The second paradox originates from the specific characteristics of franchising. Franchising has some major advantages for franchisers and its franchisees, such as low investment costs, low risk, expertise in strategy, a highly motivated group of 'autonomous', self-sufficiency members (Kaufmann & Eroglu, 1998). However, some contradicting events arise in the area of translating market demands into an effective value-creating strategy. According to Kneppers-Heijnert (1988), the franchiser supervises the use of the business format in order to enhance a uniform presentation towards customers and to preserve a uniform quality of the provided goods and/or services to customers. However, if franchisers put too much emphasis on enhancing a uniform business format, the benefits of localized operations will be endangered (Kaufmann and Eroglu, 1998). The operations may become too standardized and, as a result, they will be difficult to change. In other words, this rigidity may lead to a lack of differential power and low levels of adaptability that are required to adapt to the changing business environment (e.g. customer needs). Moreover, the strategy formation takes place at the franchiser's management based on aggregated data and not on real customer contacts. Regrettably, franchisees that are likely to have valuable input for the strategy formation are often considered only marginally. Therefore, opportunities to match consumer needs more closely are unutilized. In our paper, we focus on the retail markets, because these markets suffer from commoditization.

In sum, in the context of franchising in the Experience Economy two important paradoxes can be identified. The first paradox is controlling the risk of opportunistic behavior of franchisees with, on the other hand, keeping the franchisees' commitment high in order to form a cohesive group. The second is the paradox of differentiating the business from its competitors and delivering real customer value in spite of the highly standardized settings in the market and the top-down strategy formation. In the next paragraph, some theoretical solutions will be generated to solve both paradoxes. However, these solutions are only theoretical solutions and have not (yet) been empirically tested in the context of franchising.

3. Solving the paradoxes

The result of the approach of punishing defective behavior -instead of rewarding the augmented behavior- is that franchisees see the franchiser as an inevitable uncooperative partner (Strutton et al., 1995). This easily leads to a situation of low commitment of franchisees with their franchiser, which increases the likelihood of opportunistic behavior by franchisees and decreases the level of cooperation. As said before, the negative effects of these monitoring tasks performed by the franchiser seem to be inevitable. However, by means of implementing a rewarding system that aims at delivering enjoyable experiences to consumers, this outcome can be turned around and, as a result, a higher commitment of the franchisee can be effectuated.

The second paradox deals with the relative lack of differential power and customer orientation. With the increasingly commoditizing markets (Blackwell, 1997) a related problem arises regarding the transformation of (individual) customer needs into a clear positioning of the brand. To distinguish oneself from its competitors, one has to be different, but this difference may not harm the customer satisfaction level and the uniformity of the business format.

In the current situation retail franchisees often complain that their input regarding the fulfillment of customer needs is ignored (Tuunanen and Hyrsky, 2001). The franchiser often still defines the rules of the game, although the franchisees most of the time know their customers better. Here, we proclaim for a more bottom-up communication structure that solves the problem of consumer data being stuck at the franchisees' stores. By implementing a system that transfers specific customer data to the strategic management, a higher service level can be provided and/or even better customized products can be developed. Moreover, by rewarding franchisees to generate executable ideas (e.g., best idea contest) an incentive is present to improve customer satisfaction constantly. An added advantage to this method of rewarding is that here too the level of commitment of franchisees increases.

The most ideal way is to differentiate and simultaneously provide additional customer value. Delivering consumers a memorable experience can do this, as it is a very personal and distinct economic offering and it delivers considerable value. This idea originates from the "Experience Economy" that was introduced and further developed by Pine and Gilmore (1997, 1998, 1999, 2000, 2001). This concept provides an excellent means for these retailing franchisers and franchisees to differentiate their offerings. These authors stress the importance of customizing the products and services onto a higher level, that is to say, by staging experiences. By delivering memorable experiences to consumers instead of merely products and services, customers are attracted to the stores, which will consequently lead to higher customer satisfaction and company's sales. Mark J. Rivers, who is executive Vice President of the Mills Group Corporation, has worked with Vans Shoes to create skateboard parks, and also with Gibson Guitars to create places for people to play as well as purchase guitars. "The buzzword is experience," he says. "People want don't want to just be entertained. They want to participate. Creating these experiences is a good way to connect with consumers.”

As the prosperity has risen steadily over the past decades, people are moving upwards into the Maslow’s pyramid (Maslow, 1954). Today’s consumers are highly demanding and, to a certain extent, spoiled compared to consumers of half a century ago; it is very hard to make them happy again. Just providing quality products and services at a reasonable price is no longer enough, according to Gilmore and Pine: “Increasingly what people desire is more of an experience rather than the goods themselves. People value a place away from work and home, which used to be the corner tavern.” (Gilmore and Pine, 1997, p.38)

As services, like goods before them, increasingly become commoditized, experiences have emerged as the next step in what they call the ‘progression of economic value’ (see Figure 2).

The progression of value occurs by customizing the commodity, good, and service by taking this stage up to a higher level. That is to say, customizing a good turns it into a service, customizing a service turns it into an experience. The customization itself leads to a more valuable and differentiated competitive position in which the needs of consumers are more relevant. Starbucks is a good example of how the progression of value may take place (see Exhibition 1). Because additional value is created for consumers, a premium price can be asked.

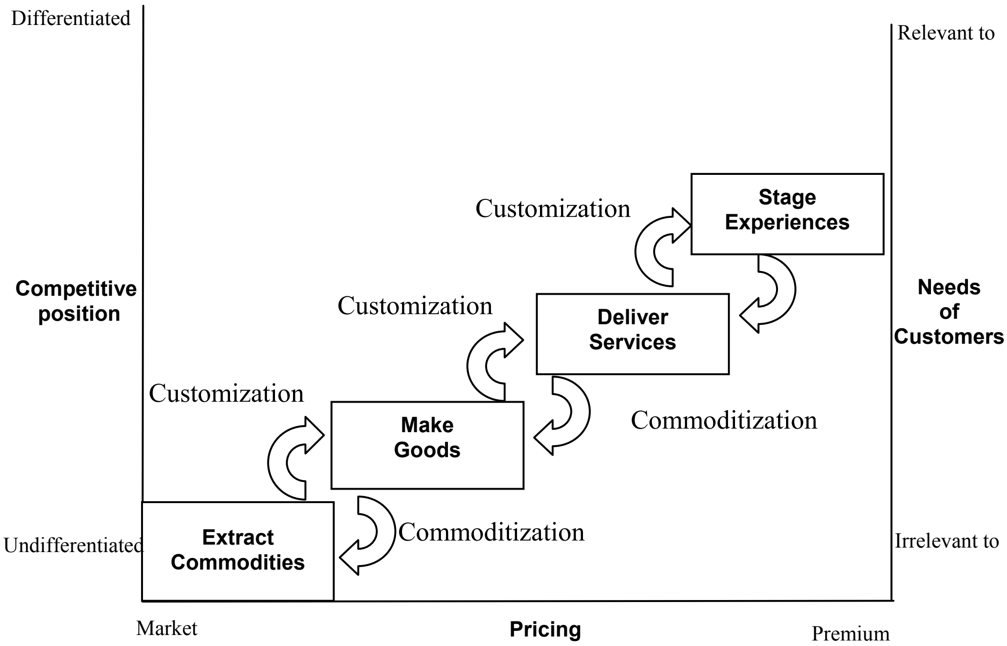

Figure 2: The Progression of Value (Source: Strategic Horizons LLP, 1999)

4. Requisites of the Experience Economy

Pine and Gilmore bear out their findings with support of some sensational examples. It all sounds perfect; just deliver experiences and surround your customers by a theatre. They will be more satisfied and to some extent even be excited (Pine and Gilmore 2000). They will become loyal customers and the business will be flourishing (Pine and Gilmore, 1998). However, not all goods and services are likely to be transformed into experiences. For example, a dentist could enjoy its customers in the waiting room. But, creating –relatively expensive- experiences during the medical check up would be distracting and unwanted.

The requisites of executing experiences effectively are predominantly based on the product-market combinations companies operate in. In our point of view, only those services and products that are related to expressional, entertainment, lifestyle products and services, are conceivable for the delivery of experiences. All these product classifications have one thing in common; they all appeal to consumers' emotions and these products are mostly consumed in a social setting. The social aspect that is affiliated with drinking coffee has clearly contributed to the success story of Starbucks (Elliot, 1997) (see Exhibition 1).

Exhibition 1: Starbucks

Starbucks started selling whole coffee beans through the traditional retail stores in 1971, but the company foresaw that it could add value by differentiating its product into a service. The service delivered, at first delivered a competitive advantage, but soon other companies, like AFC Enterprises and, more recently Diedrich Coffee, have started to imitate the service by serving their customers coffee in a social setting. In 1982, Schultz, who started as an employee, wanted to impress his bosses by what he had seen in Italy. He believed he could take the Italian culture back to the United States and create a 'third place' where people went to, to relax, meet friends and enjoy good coffee and music. He was not able to convince his bosses and, consequently, he started his own company *'Il Giornale'*. This turned out into a success and he was soon able to takeover Starbucks. In time, Starbucks created a new way to brand a product and incorporated an experience to accompany the coffee. Visitors of Starbucks are willing to pay a price premium, for example, for a cup of coffee because of the theatre surrounding its creation, and because of the esthetic environment in which it is created –even though it is still a cup of coffee.

As a base rule, customers have to value the experience itself (Kruger, 2001). According to a study of the Indiana University and KPMG performed in June 2000, people under the age of 25 are more interested in having fun while shopping and, thus, derive more value from it than older shoppers do. Consequently, creating experiences is favorable for those companies that have a relatively young customer base. These findings may imply that crowding the store with gadgets and other applications is highly successful. However, a caveat is appropriate here. According to this same study, people still want the basics in an ideal shopping experience, and they are only interested in technology to the extent that it makes shopping faster, easier, and more economical. High-tech applications can be a turn-off if it is merely used for its own sake; how it is used or what it delivers is crucial.

A clear facilitating factor to the process of staging experiences can be identified if companies have a clear distinctive mission statement and corporate identity. A good example that fits these requirements is the “The Body Shop”. Its distinctive mission statement “The Body Shop International plc – a company with a difference” emphasizes the differential power. Besides, its aesthetic, personal health and body care products in combination with the organization’s responsibility for the environment perfectly matches the emotional aspects that are at the footing of experiences.

5. Introducing the concept of the “Experience Economy” to franchisers and franchisees

Determining how much customization is required to form experiences out of products and experiences is no easy task. Which of the features or benefits of the offering should be customized and how should these be implemented by retail franchisees? Many franchisers gather the voice of the customer by using aggregated market data (Gilmore and Pine, 1999). Such information yields a great foundation for understanding the general needs of one’s customer base. However, these data are not specific enough to determine how a retail franchiser should stage its offering. Especially in those cases where future experiences should be created, it is difficult to make use of these non-directive, aggregated market data. By asking customers about their current satisfaction, managers gain little insight into what buyers truly need and where yet unrevealed needs may exist. Therefore, again the center of gravity should be placed upon the franchisees that know their customers best in order to define the desirable experience.

Kaufmann and Eroglu (1998) distinguish core elements and peripheral elements of a business format. According to these authors, the core elements of the business format should be standardized across franchisees without exceptions. The peripheral elements are amenable to adaptations if they effect a higher customer value by matching consumer needs more closely. In other words, deviations from the central elements, like the basic assortment, system name, trademark, logo, are not allowed.

On the other hand, the peripheral elements of the business format can provide numerous opportunities for adapting to individual consumer needs, for instance, by creating experiences. Each franchiser has to decide for himself what elements of the business format are core elements and what elements are peripheral elements.

Once a company realizes that it is in the business of staging experiences, there are four forms of theatre that it should consider using to do this. Pine and Gilmore have introduced a portfolio approach to classify these different forms of theatre, according to two dimensions. The first is whether the performance is stable (the same each time) or dynamic (changes each time), and the second is whether the audience itself is stable or dynamic (i.e. likely to provide feedback and input that must be incorporated into the performance) to guests. This generates the following categorization scheme:

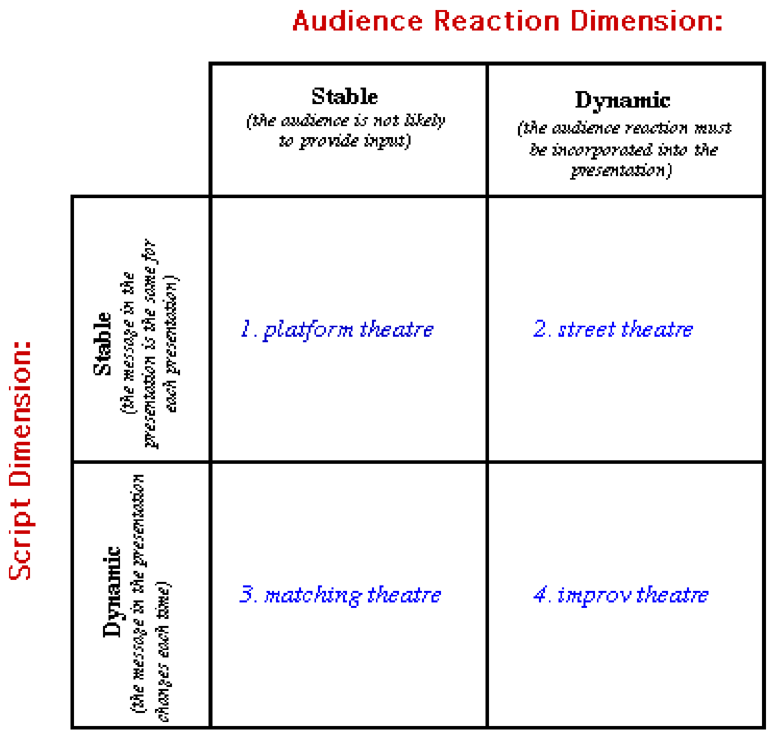

Figure 3: Four Forms of Theatre (Pine and Gilmore 2000)

These two dimensions result in the following forms of theatre:
1. *Platform theatre*: The traditional theatre, where the script doesn't vary, and the performance is done in front of an audience, which has little input into the performance.
2. *Street theatre*: In street theatre, which has traditionally been the domain of jugglers, mimes, clowns, etc. the script is stable but the audience is dynamic.
3. *Matching theatre*: Matching theatre, where the audience stays the same, but in which the messages change each time (e.g. film and television). It requires the integration of work outcomes from one disconnected time frame to another. The producers of matching theatre must concern with the alignment and connection of all those pieces. At a higher level, companies should embrace the techniques of matching theatre whenever the same customers interact with that company -often with the same workers- over and over again.
4. *Improvisation theatre*: This kind of theatre demands certain skills in terms of thinking on one's feet, responding quickly to new and changing demands from the audience.

At first sight, it seems that merely the form of platform theatre is amenable to retail franchisers. In the beginning, retail franchisees will have their hands full in staging experiences that are enjoyable and memorable. In time, as retail franchisees gain experience and become acquainted with their customers, they can start thinking about involving customers in the experience itself: thus, performing street theatre. This form requires the knowledge of the individual customer wishes and will be more difficult to implement. However, as this experience is more intense, it will be more likely to lead to a competitive advantage and to more loyal customers. The two other forms, which involve changing the message each time, are undesirable. Analogous to Kaufman and Eroglu (1998), it is assumed that changing the message every time will diffuse the standardized business format and will therefore decrease uniformity. So, franchisors need to decide what elements of the business format are core and should be standardized and what elements are peripheral and can be adapted to individual customers.

Further, the importance of 'business as usual' has implications for the delivery of experiences to customers. The entertaining offering, in whatever form, may not harm consumers. If the experience is not executed properly, the shopping experience will be damaged. In consequence, the experience has to have a focus and it may not distract consumers in finding what they came for. Stores have to consist of logical routing in which the attraction is not a distraction, but is incorporated seamlessly to attract and attain customers by offering them a pleasant feeling during shopping. Places that are entertaining, pleasant and energizing will put shoppers in the mood to make spontaneous purchases and will likely enhance store loyalty (Kruger, 2001).

Once managers have created and implemented an enjoying experience that has increased sales significantly, they should not think their success would go on forever. As with all competitive advantages, the gained advantage from these distinctive, valuable experiences are not everlasting. Experience stagers must constantly refresh their experiences –change and or add elements- to keep the offering new and exciting, and worth paying money all over again (Pine and Gilmore, 2000). Companies have to be sure to surprise their customers, once in a while, to keep the shopping experience far from 'boring'. Once they decorated their stores into a theatre, they should redesign it on a regular basis. The surprise aspect does not refer to exceeding expectations, for that would suggest an improvement along a known axis of competition, nor does it mean uncovering new dimensions upon which to compete; rather it means staging the unexpected. To capitalize fully on this remark, retail franchisers and franchisees should pass on their experiences –both physically (i.e. entertainment attributes) and mentally (i.e. ideas)- to keep the offering exciting. Despite the surprising elements, a consistent identity and business format, however, has to be maintained in the staging of experiences to form a unique and recognizable experience (Pine and Gilmore, 2000).

6. Conclusion

We have addressed some solutions to overcome the conflict of (1) handling of opportunistic behavior while maintaining a high level of commitment of franchisees, and (2) differentiating the business from competitors in a highly commoditized environment despite the highly standardized franchise settings.

The ultimate goal of franchising should not only be based on building effective relationships between the franchiser and its franchisees; it should also be on delivering real customer value by means of a joint and targeted effort. Therefore, the customer must not be held out of sight and the main goal of franchisers and franchisees should not only involve building internal relationships effectively, but also on external relationships. To leap into the stage of delivering memorable experiences to customers, the current system has to be transformed. First, an information system has to be implemented which deals with customer-specific data and in which the thoughts and ideas of franchisees are turned into strategy. Second, the input of franchisees regarding the strategy formation should be queried by means of an administrative entity and/or questioned by dint of 'best idea' concepts. By rewarding commissioned behavior –instead of punishing defective behavior- the level of commitment and cooperation of franchisees will increase. Moreover, by adopting the strategy of staging experiences, a solution is found in differentiating business in a highly commoditized environment. The pursuit of this strategy is no easy task; the right experience has to be found, the right form of theatre has to be used, the experiences should not harm the consumer from finding what he or she came for and, once in a while, the customer has to be surprised to keep the offering exciting.

7. "Pitfalls" of the Experience Economy and future research

The above sounds great; delivering experiences almost seems a guarantee for company success. The examples of Pine & Gilmore are all based on successful and intuitively attractive examples. However, there are some pitfalls to the concept of the Experience Economy. We have already slightly pointed at some of these. First, not all goods and services are appropriate for transformation to experiences. We assert that only products and services that are related to entertainment and lifestyle aspects are appropriate for staging experiences. Another important point is that the customer must value the experience and have a minimum level of commitment to become part of the experience –this in contrast to convenience-oriented shops. So before staging experiences, firms should carefully study the needs for such experiences among their customers. They should not only like the experience delivered, but they also have to buy the franchiser's products. Finally, the investments made are enormous and investors demand high turnover rates. The buy-in of the senior management is therefore crucial.

Unfortunately, there is a lack of empirical research on the success and sustainability of the Experience Economy. Additional empirical research is needed in order to grasp the viability of the Experience Economy concept. Important research questions that need to be addressed in the future are: What is the relationship between staging experiences and company success? How can we measure experiences in a reliable way? What are different strategies for implementing memorable experiences and how can the success be sustained? Which strategies are most successful? In sum, more research is needed before we can really evaluate the benefits and limitations of the Experience Economy for different companies, in different sectors, with different products and services. We hope to have encouraged other authors to investigate the Experience Economy in the franchise context.

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